

STATE OF MICHIGAN
NOTES TO FINANCIAL STATEMENTS
FISCAL YEAR ENDED SEPTEMBER 30, 1999

NOTE 18 – OTHER LONG-TERM LIABILITIES

A. Primary Government

Arbitrage Rebates

The other long-term liabilities reflected in the special revenue and debt service fund columns of the Combined Balance Sheet represent accrued federal arbitrage rebates on revenue related to General Long-Term Obligations Account Group bond issues.

B. Discretely Presented Component Units

Michigan Education Trust (MET)

The MET offers contracts which, for actuarially determined amounts, provide future tuition at State institutions of higher education. Contract provisions also allow the benefits to be used at private or out-of-state institutions, with the amount provided being based upon rates charged by the State's public institutions of higher education. The tuition payments are made by MET as a separate legal entity and these contracts are not considered obligations of the State. The Legislature is not obligated to provide appropriations should losses occur and the statutes and contracts provide for refunds to the participants if MET becomes actuarially unsound. Liabilities have been recorded on the balance sheet for the actuarial present value of future tuition benefit obligations.

The 1988, 1989, and 1990 enrollments are known as Plans B and C. Enrollments after November 1995 are known as Plan D.

The actuarial report on the status of MET Plans B and C, as of September 30, 1999, shows the actuarial present value of future tuition obligations to be \$625.9 million, as compared to the actuarially determined market value of assets available of \$725.1 million. The actuarial assumptions used include: a projected tuition increase rate of 6.30% for the years through 2005 and 7.30% for subsequent years; and a discount rate of 6.20%.

The actuarial report on the status of MET Plan D, as of September 30, 1999, shows the actuarial present value of future tuition obligations to be \$50.2 million, as compared to the actuarially determined market value of

assets available of \$52.3 million. The actuarial assumptions used include: a projected tuition increase rate of 6.30% for the years through 2005 and 7.30% for subsequent years; and a discount rate of 6.83%.

During 1999, MET changed the discount rate assumption used in determining the actuarial present value of the tuition benefit obligation. The discount rate used prior to 1999 was based on the investment yield on the cost valuation before market adjustment for certain investments held by MET. The discount rate used in 1999 is based on the investment yield on the market value of investments held by MET. This change in discount rate is accounted for as a change in accounting estimate in the accompanying 1999 financial statements. The discount rate for MET Plans B and C decreased from 7.60% in 1998 to 6.20% in 1999, resulting in an increase in the recorded tuition benefit obligation of \$38.1 million and a corresponding decrease in net income in 1999. The discount rate for Plan D decreased from 7.80% in 1998 to 6.83% in 1999, resulting in an increase in the recorded tuition benefit obligation of \$4.6 million and a corresponding decrease in net income in 1999.

On November 8, 1994, the U.S. Court of Appeals for the Sixth Circuit ruled that MET is an integral part of the State of Michigan, and, thus, the investment income realized by MET is not currently subject to federal income tax. On August 20, 1996, the Small Business Job Protection Act of 1996 (the "1996 Tax Act") was signed into law which included a provision adding a new section to the Internal Revenue Code of 1986 defining "qualified state tuition programs." A qualified state tuition program is generally exempt from income tax, but is subject to unrelated business income tax. MET has no unrelated business income. Distributions made in excess of contributions (whether to the refund designee, beneficiary, or to a college on behalf of the beneficiary) are taxable income to the beneficiary or the refund designee. The Internal Revenue Service (IRS) is expected to release regulations in 2000, which will clarify the 1996 federal legislation for qualified state tuition programs. In May 1997, MET submitted a request for ruling to the IRS for verification that MET is in compliance with the 1996 Tax Act. On December 23, 1997, the IRS issued a favorable ruling which confirms that MET is in compliance with the Act.